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December 19, 1996

Mr. William F. Caton, Acting Secretary  
Federal Communications Commission  
1919 M Street N.W., Room 222  
Washington, DC 20554

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**DEC 19 1996**

**FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF SECRETARY**

In the Matter of :

The Joint Board Recommendation )

CC Docket No. 96-45 )

Dear Mr. Caton:

Enclosed are an original and eleven copies plus two extra public copies of Comments of Cincinnati Bell Telephone Company in the above referenced proceeding. A duplicate original copy of this letter and attached Comments are provided. Please date stamp this as acknowledgment of its receipt and return it. Questions regarding these Comments may be directed to Mr. Robert J. Wentz, at the above address or by calling (513) 397-1248.

Sincerely,

David L. Meier

cc: Sheryl Todd, Common Carrier Bureau ( Paper copy and diskette)  
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**Before the  
FEDERAL COMMUNICATIONS COMMISSION  
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**DEC 19 1996**

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OFFICE OF SECRETARY**

In the Matter of

Federal-State Joint Board on  
Universal Service

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CC Docket No. 96-45

**COMMENTS OF CINCINNATI BELL TELEPHONE COMPANY**

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Filed: December 19, 1996

## SUMMARY

Cincinnati Bell Telephone Company ("CBT"), an independent, mid-sized local exchange carrier, herein responds to the questions raised by the Commission regarding the Federal-State Joint Board ("Board") Recommended Decision on Universal Service. While CBT certainly concurs with the Board's recommendation that universal service mechanisms should be established on a competitively neutral basis, CBT comments upon certain aspects of the recommendation of the Board that fail to meet this guiding principle.

CBT strongly recommends that the Commission use retail revenues as the appropriate basis for determining contributions to the universal service funding mechanism. Further, CBT submits that the Commission should use interstate retail revenues of interstate telecommunications providers as the base for assessing contributions. The adoption of such a base would be the only competitively neutral means of assessing contributions. With regard to the benchmark and cost proxy, CBT submits that the appropriate benchmark would be the basic residential revenue per line and single line business basic revenue per line. Access, discretionary, and other local service revenues should, therefore, be excluded from the benchmark.

Finally, as stated in its comments on the initial NPRM in this proceeding, CBT agrees that telecommunications services are important to schools and libraries.<sup>1</sup> However, CBT believes that the needs of schools and libraries must be balanced against the impact funding such services will have on all telecommunications customers.

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<sup>1</sup> Comments of CBT in the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45 at pp. 13-14.

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**Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554**

In the Matter of	)	
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Federal-State Joint Board on	)	CC Docket No. 96-45
Universal Service	)	
	)	

**COMMENTS OF CINCINNATI BELL TELEPHONE COMPANY**

**I. BACKGROUND**

Cincinnati Bell Telephone Company ("CBT"), an independent, mid-sized local exchange carrier, herein responds to the questions raised by the Commission regarding the Federal-State Joint Board ("Board") Recommended Decision on Universal Service.<sup>1</sup> One of the major concerns of the Telecommunications Act of 1996 (the "Act") is to make explicit all subsidies which are currently implicit. While CBT certainly supports the efforts of the Board to construct a universal service mechanism that replaces the current implicit subsidy mechanisms, CBT asserts that perhaps the most crucial subsidy transformation that is required is the rebalancing of rates and not the continuation of artificial rate subsidies. Efficient competition cannot develop in a market in which regulations force incumbent carriers to maintain rates based on historical social policies, while new entrants are allowed to purchase unbundled elements at TELRIC or to purchase services at deeply discounted wholesale rates.

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<sup>1</sup> In the Matter of the Federal-State Joint Board on Universal Service, **Recommended Decision**, CC Docket No. 96-45, released November 8, 1996.

By definition, efficient competition is an environment in which firms succeed or fail based upon their own abilities, rather than external influences or artificial market barriers and conditions. Truly efficient competition can only exist in a free market where each firm is free to act independently and set its prices rationally and in accordance with market forces. The local telephone business has not been and is not now an "efficient" marketplace. That is because prices are regulated and influenced by many non-market forces. As such, the incumbent providers have been shouldered with public service burdens such as the obligation to be the carrier of last resort and the obligation to provide universal service. Social policies, like universal service, have dictated that residential rates be maintained as low as possible. As a result of these policies, the incumbent LECs' revenue requirements have had to be disproportionately satisfied from other sources, traditionally from sources like business rates, access charges, and optional services. Local telephone rates contain a variety of explicit and implicit subsidies that have developed over many years, whereby the prices of some services are higher and the prices of other services are maintained lower than what would prevail in a non-regulated market. These pricing differences are primarily due to regulatory influence, not market forces. In order for true competition to be realized, these implicit rate subsidies must end as quickly as practical. For this reason, CBT believes that the goal of the Commission should be to minimize universal service funding at the federal level and leave it to the states to determine the appropriateness of the fund and who should be the recipients of such funding.

The existence of rate subsidies gives the new entrant the ability to extract profits not due to its own efficiency, but rather due to the inefficiencies built into the incumbent's rates

through traditional social and regulatory policies designed to maintain affordable service for residence customers. In an efficient competitive market, prices can be automatically adjusted to accurately reflect market efficiencies. However, in the case of an incumbent LEC subject to regulatory oversight, this is not easily accomplished. A rate adjustment necessary to rebalance rates and remove subsidies requires state commission approval, which generally takes many months to achieve. CBT intends to begin this process in its Ohio service territory and calls upon the Commission to assist in redirecting these subsidies at the federal level.

As Chairman Hundt stated in his November 20, 1996 address to NARUC, "To decouple universal service from monopoly means that contributions to the universal service fund, and disbursements from it, must not be biased either in favor of or against the incumbent, not in favor of one kind of competition, or another." Chairman Hundt's statement is certainly consistent with the Recommended Decision of the Board, which includes the principle of "Competitive Neutrality" as an additional guiding principle in establishing the new Universal Service Fund.<sup>2</sup> While CBT certainly concurs with the Board's recommendation and the Chairman's interpretation that universal service mechanisms should be established on a competitively neutral basis, CBT feels it must comment upon certain aspects of the recommendation of the Board that fail to meet this guiding principle.

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<sup>2</sup> **Recommended Decision, ¶ 23.**

## **II. DISCUSSION**

### **A. The Failure of the Board's Recommendation to Meet the Stated Goal of Competitive Neutrality**

One area where the recommendation of the Board fails to be guided by the principle of competitive neutrality is in the formula for determining the "Basis for Assessing Contributions". The Board recommends that contributions be based on a carrier's gross telecommunications revenues net of payments to other carriers.<sup>3</sup> This method puts the incumbent LEC at a competitive disadvantage.

While the Board states that this approach approximates more closely a value added contribution<sup>4</sup>, this is simply not supported by the evidence in the record of this proceeding or by the experience of telecommunications carriers. From a basic economic perspective, value added relates to a profitability measurement (revenues - expenses) approach. In this case, only carriers who make payments to other carriers (e.g., IXCs, Resellers, etc.) will receive a value added base for making contributions while incumbent LECs will be required to pay on a gross revenue base.

The following example illustrates the inequity:

- Carrier A has \$100 of gross revenue
- Carrier B has \$100 of gross revenue, but pays Carrier A \$20 to complete his service
- Assume a 10% Contribution Rate

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<sup>3</sup> **Recommended Decision, ¶ 807.**

<sup>4</sup> Id.



- Carrier A pays \$10 =  $(\$100 * 10\%)$
- Carrier B pays \$8 =  $[(\$100 - \$20) * 10\%]$
- Carrier A effective contribution rate 10% =  $(\$10 / \$100)$
- Carrier B effective contribution rate 8% =  $(\$8 / \$100)$

As can be seen from this example, Carrier A has a 25% higher effective contribution rate than Carrier B. The method which the Board is recommending allows carriers who buy services from other carriers to have a special deduction, thereby paying a lower effective rate. Such a mechanism gives those carriers a competitive advantage. Looked at another way, Carrier A is paying on gross revenues, while Carrier B is paying on the value/profit margin (Revenues - Expenses). In addition to failing to be competitively neutral, this method clearly does not meet the standard established by Section 254(d) of the 1996 Telecommunications Act where Congress stated that all providers of interstate telecommunications shall contribute on an “equitable and nondiscriminatory” basis to universal service support mechanisms.

CBT strongly recommends that the Commission use retail revenues as the appropriate basis for determining contributions to the universal service funding mechanism. Should the Commission not accept retail revenues as the basis, then it should adopt gross revenues as the standard for all carriers, as the Wisconsin Public Service Commission recommended.<sup>5</sup> The current funding for Telecommunications Relay Service (TRS) uses gross interstate revenues as the basis for contributions

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<sup>5</sup> **Recommended Decision**, ¶ 809.

because it was determined to be the most equitable basis for funding. In addition, this would eliminate the concern of the Illinois Commerce Commission that wholesalers would not contribute directly to support mechanisms.<sup>6</sup>

A second area where the Board recommendation fails to follow the principle of competitive neutrality, as well as the intent of Congress in Section 254 (d) of the Act, is in its recommendations regarding "Revenues Base for Assessing Contributions". As Commissioner McClure correctly recognizes,

Using both interstate and intrastate revenues of carriers that provide interstate services creates an inequitable and discriminatory basis for contribution. Telecommunications traffic carried by a carrier only authorized to provide intrastate telecommunications services will not be subject to contributions while similar traffic carried by an interstate telecommunications carrier will be subject to contributions for federal USF.<sup>7</sup>

Clearly, this creates a competitive cost advantage for those new entrants who are considered carriers of only intrastate traffic.

As Commissioner McClure has recognized, the emerging competitive market will result in a blurring of the lines separating interstate and intrastate traffic, making it difficult to determine what is truly interstate or intrastate traffic and which carriers are solely intrastate or interstate for the purposes of universal service funding. However, the Commission appears to be basing its universal service funding mechanism on only interstate carriers' revenues, as a result of uncertainty over its

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<sup>6</sup> **Recommended Decision**, ¶ 812.

<sup>7</sup> Commissioner Schoenfelder also recognized this inequity in her separate statement.

statutory authority to include intrastate carriers. Under such a scenario, many new entrants would possibly seek only intrastate certification to avoid contributing to the federal universal service mechanism. Further, as stated above, it would be very difficult for regulators to monitor and to prevent these carriers from providing interstate services.

As the Commission has concluded that it has no authority to force intrastate only providers to contribute to the federal universal service mechanism, CBT submits that the Commission should use interstate retail revenues of interstate telecommunications providers as the base for assessing contributions. The adoption of such a basis by the Commission would be the only competitively neutral basis for assessing contributions.

In prior comments filed by CBT regarding universal service funding, CBT asserted that only ILECs should be eligible to receive compensation from the universal service fund. CBT states that the requirement that carriers ". . . offer defined services throughout the service area" is ambiguous in that a new entrant ("NEC") could offer service to the business customers in a particular region without offering the same service to the residential customers in that area.<sup>8</sup> While the Board has dismissed "cream skimming" as implausible, the fact is it still exists. In a recent certification hearing in Ohio, the CEO of Communications Buying Group ("CBG"), while stating in his prefiled testimony that CBG planned to serve residential and business customers, admitted, under cross-examination, that its strategic intent was

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<sup>8</sup> **Recommended Decision**, ¶ 156.

to serve small and medium-sized business customers.<sup>9</sup> Based upon the Board's recommendation, this carrier could receive support for the total area.

The Board also states that ". . . symmetrical regulatory obligations on all carriers receiving universal service support are unnecessary to protect the incumbent and would chill the competitive entry into high cost areas."<sup>10</sup> CBT disagrees and offers that symmetrical regulatory obligations are needed to ensure that all carriers providing service to end users operate under the same rules. The position taken by the Board regarding the need for a symmetrical regulatory scheme is inconsistent with its stated goal of competitive neutrality.

#### **B. Benchmark & Cost Proxy**

CBT is concerned with the Board's recommendation that the Commission adopt a benchmark revenue per line which includes all local, access, and discretionary services. As stated previously, one of the goals of the Act is to make explicit all subsidies which are currently implicit.<sup>11</sup> By including access, discretionary, and some local service revenues in the calculation of the benchmark, this goal of the Act will not be met because an implicit subsidy mechanism will continue to exist.

It is CBT's understanding that the cost proxy model develops the cost of service within the definition of universal service. The proxy models are designed to

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<sup>9</sup> Testimony of Robert B. Daly, August 20, 1996, PUCO Case No. 96-431-TP-ACE.

<sup>10</sup> **Recommended Decision**, ¶ 156.

<sup>11</sup> Telecommunications Act of 1996, § 254.

calculate the cost of the following:

- Cost of voice grade access with the capability to complete local calls;
- Cost of DTMF or touchtone;
- Cost of access to emergency services, but not the cost of the services;
- Cost of access to operator services, but not the cost of the services;
- Cost of access to interexchange carriers, but not the cost of call completion;
- Cost of access to directory assistance, but not the cost of DA call completion;
- Does not include the costs associated with discretionary services.

The Board should modify its benchmark revenue per line to more appropriately match the costs associated with universal service as determined by the proxy models, in that the cost of the services are not included by the Commission in its proxy model. As a result of this methodology, implicit subsidies will continue because revenues will be mismatched with the costs from the proxy model.

CBT submits that the appropriate benchmark would be the basic residential revenue per line and single line business basic revenue per line. Access, discretionary, and other local service revenues should, therefore, be excluded from the benchmark.

### **C. Recovery of Regulatory Obligations**

In order to ensure that competitive neutrality guides the creation of a

universal service funding mechanism in the competitive market, the Commission must adopt a mechanism that provides for the recovery of prior investment in the switched network made by incumbent LECs. CBT submits that without the ability to recover the costs of these investments, incumbent LECs will be placed at an extreme competitive disadvantage. As a result of being designated Carriers Of Last Resort ("COLRs") by regulatory bodies, incumbent LECs have made large investments in the public switched network so that any request by a customer to be attached to the network could be accommodated in a short and timely manner consistent with incumbent LECs' mandated obligation to provide service on demand.

Both the Commission and the Board must recognize that it was regulatory action which mandated the levels and timing for recovery of depreciation and return which were allowed to be recovered from the investments made by incumbent LECs, as well as the allowable rate subsidies to be recognized in rate structures. In the more competitive environment, absent either the removal of the COLR burdens or the opportunity to recover the cost of these investments in a more timely manner, competitive neutrality is unattainable. This places incumbent LECs at a distinct competitive disadvantage, in that the rates paid by customers reflect historical regulatory policies and are higher than they would be if incumbent LECs were allowed to set its prices in a competitive market.

#### **D. No Recovery Mechanism for Contributions to Universal Service**

While the members of the Board in their separate statements acknowledge that the ratepayer/end user will ultimately pay for any universal service funding mechanism, CBT submits that the Board's recommendation does not provide a mechanism for contributing carriers to recover their contributions. The rules for interconnection, which the Commission has adopted in CC Docket No. 96-98, exclude universal service funding from recovery since such costs are not associated with interconnection. The Board also takes the position that an end user surcharge imposed directly on consumers for the recovery of this contribution violates the Act.<sup>12</sup> However, it is also clear that the contribution levels in rates which currently provide subsidies for the provision of universal service will be eliminated by price competition. Therefore, given the inherent inconsistency in the logic used by the Commission, CBT asks the Commission and the Board to clarify how CBT or any other carrier is to recover its contribution to the universal service funding mechanism, if they are unable to recover these contributions from end users.

#### **E. Schools and Libraries**

As stated in its comments in the initial NPRM in this proceeding, CBT agrees that telecommunications services are important to schools and libraries.<sup>13</sup> However, CBT believes that the needs of schools and libraries must be balanced against the

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<sup>12</sup> **Recommended Decision**, ¶ 812.

<sup>13</sup> Comments of CBT in the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45 at pp. 13-14.

impact funding such services will have on all telecommunications customers. At a time when the size and method of funding the basic universal service mechanism has not been determined, CBT submits that there is no basis for the Commission to determine that \$2.25 billion is the appropriate amount for schools and libraries. Furthermore, CBT believes that decisions regarding the needs of schools and libraries are best made at the state and local level, where curriculum decisions are made, rather than by the federal government.

1. Size of the Fund

Although CBT understands the eagerness of the Board to ensure that schools have access to the latest in telecommunications technology in order to prepare students to enter the workplace of today and tomorrow, CBT is concerned that in its eagerness, the Board may have lost sight of the overall goal of universal service. As with many programs, there are unlimited wants and limited resources. In this case, the unlimited desires of schools for access to the latest developments in telecommunications services must be tempered by the reality of the impact that meeting these requests will have on consumers' telecommunications rates. At the same time that the Board is wrestling with how to keep basic telecommunications rates affordable for consumers, it is suggesting providing discounts for schools and libraries of up to 90 percent in some cases for everything from a basic voice grade line to inside wire to Internet access.

If funded on a per line basis, CBT estimates that consumers could see increases in excess of one dollar per month solely to fund services for schools and



libraries. As Commissioner Chong aptly points out in her Separate Statement on the Board's recommended decision:

Let us make no mistake about who will foot the bill for this universal service program. It is not the telecommunications carriers, but the users of telecommunications services to whom these costs will be passed through in a competitive marketplace.<sup>14</sup>

Although Congress, in the Act, called for discounts for schools and libraries, CBT submits that it also expected that discretion would be used in deciding exactly what services would be offered at discounted rates. Just as Congress does not take lightly its ability to impose taxes, CBT believes that Congress expects that before implementing what amounts to a \$2.25 billion charge to consumers, the Board and the Commission would fully analyze the impact on consumers. CBT believes that until the amount of the total universal service fund is determined and a funding mechanism developed, a decision cannot rationally be made on expanding the education portion of the fund beyond core services.

## 2. Inside Wire (Internal Connections)

CBT submits that under no circumstances should inside wire be funded under universal service. As Commissioner Chong and Commissioner Schoenfelder observe, as well as Representative Jack Fields, inside wire is plant and equipment, not a telecommunications service and as such is beyond the Congressional mandate

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<sup>14</sup> Commissioner Chong's Separate Statement, p. 11.

of providing discounted service to schools and libraries.<sup>15</sup> Based on the estimates provided by McKinsey and EDLINC, including inside wire could dramatically increase the cost of universal service funding.<sup>16</sup> Thus, CBT submits, even if the Commission does not agree that inside wire is outside the Congressional mandate, inside wire should not be included at this time simply due to the financial impact it will have on the size of the fund. Furthermore, since inside wire has been deregulated for some time and the market is clearly competitive, schools have opportunities to solicit bids from many different providers and to negotiate for discounts to meet their needs. In short, there is no need for subsidies for inside wire.

### 3. Economically Disadvantaged School Discounts

CBT also urges the Commission to revisit the Board's recommendation that larger discounts be provided to schools with larger numbers of economically disadvantaged students. Although there may be merit to designing a program that targets aid to the districts most in need, CBT submits that it is not appropriate to equate the wealth of a school or school district to the wealth of its residents. There are too many factors that go into school funding to make such a simplistic connection. Schools across the country still rely heavily upon property taxes to fund schools, state school funding formulas vary from state to state and states are at

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<sup>15</sup> **Recommended Decision**, ¶ 470. See also, Commissioner Chong's Separate Statement, p. 6; Commissioner Schoenfelder's Separate Statement.

<sup>16</sup> **Recommended Decision**, ¶ 469.

varying stages in providing state funding for telecommunications services in schools. All of these factors should be considered in order to equitably and efficiently allocate universal service funds to schools.

To illustrate why the wealth of a school district cannot be determined by the wealth of its residents, one need not look too far. For example, in CBT's own territory there are several school districts whose property values per pupil and estimated property tax revenue per pupil, significantly exceed the statewide average. However, the average income of the residents in the districts are well below the statewide average. One district in particular has the 32nd highest per pupil property value out of 611 school districts in the state of Ohio, yet ranks 539th when measured by average federal adjusted gross income.<sup>17</sup> Although CBT was not able to ascertain the number of students in the district enrolled in the national school lunch program<sup>18</sup>, based on the reported federal adjusted gross income, it appears likely that schools in the district would qualify for higher discounts based on the Joint Board criteria.<sup>19</sup>

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<sup>17</sup> Ohio Department of Taxation, Tax Data Series, Table SD-1, No. 34, August 16, 1996 and Table Y-2, No. 46, July 15, 1996.

<sup>18</sup> According to the Ohio Department of Education, information on the National School Lunch program may not be used for anything other than its stated purpose without the written consent of the parents of the students receiving the lunches.

<sup>19</sup> It is not clear from the Board's Recommended Decision if the economic disadvantage of a school would be based on the total number of students enrolled in the National School Lunch Program or only on the number of students eligible for reduced price or free lunches under the Program. In paragraph 564 reference is made to students eligible for free lunches or lunches at reduced prices, while paragraph 566 recommends that schools

Kentucky provides another example of why the discount for a school should not be based solely on the wealth of its residents. As a result of the Kentucky Education Reform Act ("KERA"), the higher tax-based school districts in the commonwealth provide funding, through a redistribution of school taxes, to other, and in most cases, more economically disadvantaged school districts within the commonwealth. This redistribution does not, however, change the level of wealth enjoyed by the population of that school district, nor does it change the number of children enrolled in the lunch program. At the same time a program such as KERA is attempting to equalize school funding among districts in order to provide equal educational opportunities to all school children, the Board's recommendation would tip the scales in favor of certain districts based on a factor outside of the state's carefully crafted funding formula. This is perhaps a perfect example of why most of the decisions of how and what type of educational discounts should be provided to schools and libraries is best left to the states to determine. A federal program that mandates specific discounts down to the individual school level cannot possibly lead to an efficient distribution of funds because of the vast differences between schools and education funding programs across the nation.

#### 4. Effect on Competition

CBT also believes that a fund of the magnitude contemplated by the Board could stifle the competition in the telecommunications market for schools. Further,

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certify the percentage of students eligible for the national school lunch program, not just those eligible for free or reduced price lunches.

this proposal could hinder innovative partnerships between schools and businesses, which can bring not only advanced telecommunications services to schools, but also can facilitate contacts between students and businesses, so that the students can experience first hand how businesses use telecommunication and information services in the workplace. CBT believes that as competition develops, there will be less need for mandatory discounts for schools and libraries. As schools have more options available to them they will be able to negotiate for discounted rates or packages of telecommunication and information services to satisfy their needs. However, if companies are required to provide additional discounts from their already discounted offerings to schools they may be less likely to offer the same discounts they would otherwise have provided. Furthermore, there may be less incentive for schools to shop for the most efficient provider of services if they know they will receive a discount regardless of who provides the service.

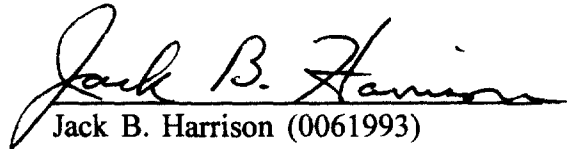
For all of the aforementioned reasons, CBT urges the Commission to limit the scope and size of the education fund at least until the basic USF issues are resolved and the impact of its decision on all telecommunications users can be thoroughly assessed.

### **III. CONCLUSION**

CBT respectfully requests that the Commission consider these comments as it develops its response to the Recommendations of the Joint Board on Universal Service. CBT urges the Commission to move toward the elimination of rate

subsidies, so that efficient competition may flourish, minimize the size of the federal universal service fund, allow the state commissions to determine the universal service fund needs for their respective states, and adopt a mechanism that reflects the historical regulatory burden that has been placed on ILECs as the COLR, so that these carriers are not placed at a competitive disadvantage in the changing telecommunications market by being unable to recover historic investments made to meet past universal service obligations.

Respectfully submitted,



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